Foreign Exchange
and
Foreign Business Outlook

Address by

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Distributed by

Illinois Manufacturers' Association
76 West Monroe St.
Chicago

LUNCHEON

of the

Illinois Manufacturers Association

Louis XVI Room,
Sherman Hotel, Chicago, Illinois,
Tuesday, February 24, 1920.

Speaker: Mr. Allen Walker, New York City.

Subject: Foreign Exchange and Foreign Business Outlook.

Mr. William Nelson Pelouze presided.

PRESIDENT PELOUZE: Members of the Illinois Manufacturers Association: There is perhaps no subject that is attracting the attention of the financial world today more than that of foreign exchange. Our foreign export has become mightily affected by the existing abnormal ratio of that exchange. They have both at the present time become inseparably interwoven to the extent that one has a large influence upon the other.

Our distinguished guest today, because of his prominent connection with what is known to be the largest international institution of its kind in the world, has had every facility and opportunity to study these great questions. He has kindly consented to address our members today on foreign exchange and on the foreign business outlook.

It is with very great pleasure that I present to you Mr. Allen Walker, of the Guaranty Trust Co. of New York.

Mr. Allen Walker: Mr. Chairman and gentlemen: It is a very great pleasure to have the opportunity to come and meet with business men of your activities and your standing in the middle west, and it is particularly pleasurable just now to get away from New York, which has had much more snow than you have, and is rather impossible to get around in. I cannot give you a better example— to indicate what condition we have been in down there—of the difficulties of transportation and traffic than to relate a little incident which happened in regard to our own institution the other day. A small boy called up one of the managers during the big storm there

and said, "Say, Boss, I won't be down today, if you don't mind; I haven't yet got home yesterday!"

The state of the boy and the boy's mind is not unlike the whole international credit situation at the moment. It has not found its bearings. And businessmen everywhere are saying: "What is going to happen? What underlies the present exchange situation? What are the factors for which we must watch in order to be able to base our activities and our business judgments upon those tangible things which shall guide us in laying out our business programs for the ensuing year or two?"

The whole credit and domestic business situation is so closely interwoven with that of the foreign situation, that it might be serviceable if I dwelt for a moment in the general business situation here, and what is likely to happen. I have said that the country never has been so busy and prosperous in all its history as at the present time. Despite the decreased purchasing power of Europe, and the unprecedentedly adverse exchange rate, we have piled up a colossal trade balance in our favor of $4,000,000,000 in a single year—1919. This has been, of course, a tremendously potent factor in keeping our industrial fields operating continuously and profitably. It has involved an unparalleled call for capital and a demand for credit that has broken all records.

Few of us have stopped to realize the problems which our very prosperity has been creating for us. With continued high prices and the consequent need for more capital with which to transact business of every character, we are now called upon to answer the question as to whether or not there is going to be money enough to finance the great volume of trade at prevailing prices. We are reaching the limit of our national credit resources, and the financial authorities have seen the need for quick and effective conservation. The business men of the country —our customers among the rest— must help remedy the serious situation for their own protection and for their own profit. None of us with any of our agencies can do it alone. It is a question of team work and co-operation between business men and financiers.

There is an unprecedented demand for money; there is only a limited supply. That supply must be used wisely to create new wealth and to pro-

mote productivity. It cannot be dissipated, or even partly wasted in speculative, unproductive, or unessential business ventures, enterprises. From now on the bankers of the country must apply a very strict gauge in granting credits. They must. It will be to the ultimate advantage of business interests generally to co-operate fully with the bankers in maintaining this standard. Unless this co-operation is forthcoming, we must all be prepared to face greater credit inflation, still higher prices, and eventually a crisis which may precipitate a reaction with its attendant evils.

This does not imply that there is likely to be a serious business recession. The result should be quite the contrary if our national business affairs are wisely conducted. We cannot, however, too strongly emphasize the imperative need for the conservation of credit resources, for concentration upon increased production of essentials, for government and individual economy, and for thrift.

There is no need for legitimate, essential business to retrench. On the contrary, there is every reason why it should expand to meet the necessary economic demands,—I mean legitimate, essential business. But business cannot do that, however, if unessential enterprises are permitted to drain the reservoir of credit and capital.

The recent action of the Federal Reserve Board in raising discount rates, ranging from five per cent for bankers' acceptances to six per cent for commercial paper, is the most important attempt yet made by that Board to bring about a contraction of credit. The liquidation of unnecessary loans, which would result from this action, ought to bring about a steadily increasing supply of funds for more vital needs. A gradual restoration of normal conditions should ensue. Accommodation for strictly legitimate business requirements should not be denied nor even curtailed by the bankers. There ought to be more money available than at present for such purposes.

There must be, however, a definite discouragement of unnecessary borrowings, because the margin between the former Federal Reserve discount rate of 4¾ per cent and the market rate of 6 per cent no longer exists. When borrowers seek new loans they must expect strict examination as to what the money is wanted for. Doubt-

less, recognizing the conditions, they will help in the necessary analysis.

It has been predicted that the raising of the discount rates by the Federal Reserve Board may mean the beginning of a "break in commodity prices." It does not seem likely, however, that there will be any *precipitate* drop in prices. Whatever decline in commodity prices may be effected will be due to the influence which the higher rates may have in diverting money and credit from non-productive ventures into productive enterprises, and thereby increasing the volume of necessary commodities.

It probably will take some years before the world production can again become normal. Europe has only 55 per cent of its food requirements today. This means, of course, greatly decreased production of all materials over there, as well as intense sufferings, for factories can not operate and dwellings cannot be heated without fuel.

Europe must have these necessities, and since the law of supply and demand is constantly operative, there is seemingly little prospect of materially reduced prices for the immediate future of what we call "necessities."

From both European and our own enterprises we must expect heavy demands for capital goods to replace those destroyed or worn out, and until we catch up with these demands productivity must be affected. The foreign trade of the world needs more ships. Building operations have lagged far below normal. Interest rates and the declining bond market reflect the situation in the investment field. There is a growing demand for investment capital and a great shortage of supply.

The cost of money exercises an important influence upon prices, and money costs, like commodity costs, are determined by the simple law of supply and demand, which is something that many men do not seem to understand, that money is a commodity just like anything else, and that the law of supply and demand operates in the usual way. Interest rates are not fixed arbitrarily by bankers, but are based upon the value which the public fixes upon money and upon the price at which security issues will be absorbed. Price of luxuries may fall soon, but prices of the more necessary articles seem likely to continue high, because the consumption of

the whole world has increased so far beyond any one's pre-war dreams. It is hoped that this may serve to bring about an increased output of the necessities of life, and that is the only real solution of the reduced cost of living.

Now the question on everybody's lips is: How about this foreign exchange question? And there is a very definite connection between the foreign situation and our domestic business, as I have stated.

In spite, or rather, because of the colossal trade balance referred to, the depreciated currencies of European countries are militating against us very decidedly. These countries now are buying heavily from us because they are compelled to do so; but they are endeavoring now—I believe they are beginning rightly—to restrict purchases to absolute necessities. Even with the application of severe self-denial, however, there must come a time when they will have reached the limit of their immediate buying power and when they must deny themselves even necessities.

Meantime the present demoralized exchanges are acting in many countries as an invisible tariff against American products. A diminishing demand abroad for our goods must assuredly menace our prosperity, because in all our history foreign trade has never played so important a part as it does today in turning the wheels of American industry.

Considered alone from the point of view of what is good business for us, it is imperative that the United States should do two things, namely, take more of Europe's goods in exchange for American products, and find a way in which to grant Europe adequate credits to finance the purchase of raw materials and other necessities. But at the same time, endeavor to find no artificial vehicles for the extension of credit, which ordinary business processes would not demand.

The stabilization of exchange is contingent upon more than trade balances and credit arrangement, however. It is dependent, in large measure, upon the credit and currency conditions in European countries. Those countries must deflate and return to the gold standard before their exchange can move steadily upward. Moreover, if European countries plead that credit should be extended to them upon a business basis, then they must expect lenders to discriminate and exercise all proper business precautions in the

extension of credits. On our part, we should not hesitate to let it be known that we hope to see those countries taking immediate steps to adopt sound financial and taxation programs as the primary means of re-establishing their economic stability.

You may have noticed what Mr. Hoover said last night:

"Our best assistance in healing Europe's economic wounds lies in the promise of the great processes of private commerce, not in new loans from our government."

There is nothing mysterious whatever about the exchange situation when one has clearly in mind the controlling factors. Let us take the United States and Germany, for example, in making a comparison of credit standings. In the United States today we have more than one-third of the world's gold supply, and national wealth of more than two hundred and fifty billion dollars, a net national debt less than twenty-five billions, and a national budget of about five billions. In contrast, Germany has a negligible supply of gold, being, in fact, upon a paper basis today, owing fifty billions dollars in national debt and carrying an annual budget of eight billions. Need there be any mystery as to the reason for the depreciated mark, or the appreciated dollar in exchange relations between the two countries? An examination of the financial condition of other European countries will show that a similar disparity exists between them and the United States, in greater or lesser degree, and readily accounts for the difference in national credit. The note circulation of France (the paper currency), more than six times its pre-war level. The note circulation of Italy is over five times its pre-war level. The note circulation of Germany is about ten times the pre-war level. In each case the disparity between the volume of paper currency and the gold reserve is very great. These factors affect the exchange rates, quite apart from the question of trade balances.

Today, there are more than the usual number of questions to be answered by those seeking credit on this side of the water. And because there are not satisfactory answers, as we see them, to those questions, America cannot see her way clear to give the quick, ready, immediate kind of help that Europe has been seeking, apparently. As a blanket statement, it may be said

that there is no such thing as normal credit in Europe today. When we think of extending commercial credits to Europe at this time, we not only have in mind the ascertainment of regular credit information; we want also to feel assured as to the political stability, the existing social order, the prevailing respect for the rights of property—because property, after all, in one form or another, is the ultimate security back of every credit granted—and something as to the soundness of the reconstruction program of the national government of each nation we are seeking to serve.

There is no artificial means by which restoration to normal conditions can be compelled by any sudden process. There isn't any way it can be done. Nothing but the natural laws of trade can operate effectively to bring about the necessary readjustment. Europe somehow must contrive to produce more goods for sale in this market and to get along with fewer purchases, and American producers must make up their minds that fewer purchases from Europe are going to take place, and that their buying power being more and more restricted, is going to mean a still further recession of purchases on this side.

But I would have you manufacturers remember that Europe is not the whole world. That the buying power of the rest of the world is greater than it ever was. I have talked with manufacturers, producers, merchants, who have come to my desk to discuss foreign transactions and foreign trade and export. They have been doing business exclusively with Europe for a number of years, and I have sensed that they seem to have no other countries than Europe in mind as a possible field for export of their surplus product, or any other countries than Europe as the territories in which to lay their plans for future business.

Why, gentlemen, the Far East today is developing a purchasing power by leaps and bounds, which nothing but a close analysis of the figures can make realizable. The Far East today, China particularly, offers a prolific market for the American producer in almost every major line of industry.

In South America the dollar is at a discount, and never was there more reason than today, never was there more good, sound business reason for the American producer to extend his markets to South America. And there is opportunity galore.

There are three separate and major obstacles to the revival of European trade; a mal- adjustment between internal prices and international prices; a lack of individual credit wherewith European consumers may buy the raw materials needed to secure the working capital and to restart the circle of exchange; and a disordered currency system which renders credit operations hazardous or impossible quite apart from the ordinary risks of commerce.

Almost daily we are being asked as to what justification there is, if any, for statements appearing in certain sections of the foreign press to the effect that the United States is displaying economic selfishness and seeking to maintain the dollar premium for her own commercial gain. This kind of comment is not intelligent. America cannot help the situation, nor is there anything she can do, within the scope of sound, legitimate business, to remedy existing conditions. We all realize that unfavorable exchange rates make it almost prohibitive for us to sell goods to Europe. Who, in America, even from a purely selfish point of view, wants such a condition to continue? Existing circumstances simply are beyond our control.

During 1918 we imported from Europe $318,000,000 worth of goods, and in 1919 we imported $750,000,000 worth. This proportion is greater than the increase of our exports, to which the imports are really due. In contrast, we have been and are exporting gold to Argentine, with which we have been contracting our trade. That is the exact reverse of the condition across the Atlantic. We are selling to Europe so much that Europe cannot pay for it. We are buying from Argentine so much that we must pay in gold in order to maintain exchange. The two cases call for opposite remedies. If trade with Europe should be contracted, certainly it should be expanded with any country which now has power to take our gold.

The only way to keep trade moving is by a courageous policy—not hesitating to do business because of a feeling that everything is going to the dogs; allowing credits discriminately on a basis of liquidating debts of goods with goods. Finance credit cannot be enlarged and should not be contracted too suddenly nor too extremely. I have little patience with those who would seek to

bring about deflation over night, and attempt to remedy things by some sudden process arrived at during a few hours' consultation. It is impossible to bring about sensible readjustments in any organization, international, national, or corporate, by any series of violent jerks. It can be done only by a gradual strengthening of the whole economic fabric.

Let us refer to Canadian exchange for a moment. We have been supplying Canada with an enormous quantity of goods, much in excess of the volume we have been taking from her. This means that Canada has been making a preponderant volume of remittances for the goods she has purchased from us and that she has been bidding with the rest of the world for the American dollar. The volume of her commercial bills, like any other commodity, with the same law of supply and demand operating, in the Amerian market has, by the application of those laws, cheapened the price and lowered her exchange rate. There is no sentiment in the matter at all. Money is a commodity like anything else which is bought and sold in the public market.

It is impossible for any one to say when foreign exchange will improve, and by what degrees. Conditions would seem to indicate that a normal situation can be reached only by gradual adjustments over a period of from three to five years—perhaps longer. When some form or international peace is consummated by the United States, when European boundaries have been permanently fixed so that the new nations know exactly "where they are at," when they have been enabled to procure food and fuel, raw materials, and machinery, and seriously start all their people to work, start their factories going under steady pressure, and produce as in prewar days, then we may all feel that the world is on a sure road towards definite reconstruction. The general feeling of confidence created by this actual knowledge will mean a better business sentiment, easier money, easier credits, and a saner world all around. Business men will be able to watch and judge for themselves as to how these conditions are to be arrived at, step by step.

Before I conclude, I just want to say a word on the subject of increased production, international as well as national, because it is upon

that factor, above every other factor, to my mind, that solid reconstruction depends.

Increased production, in the United States and the world over, is not a problem confined to the financier or the economist, but is every man's problem. There never was a time in the history of the world when it was such a vital question as it is with us all today. And when you ask 'What are we to do about it?' there is only one answer: 'Try and make the gospel and the interpretation of it so clear and so simple that every man whom you employ and every man who is your neighbor shall help develop a patriotism of peace and insist that a full day's work for a full day's pay shall be as much a matter of national pride as is the individual pride in Old Glory itself."

A great many thoughtful men have been giving their minds to the solution of this problem lately. Every wage earner, every housewife, every home builder is crying out against abnormally high prices for the necessities of the breakfast table. There is but one answer: Increase production.

We are asked to find means of extending credit to Europe, in order that lives may be saved and the wheels of industry there kept going. There is but one verdict: Increased production.

Under production is not limited to local or even a national malady. It is a world-wide condition at this moment. Everywhere the demand exceeds the supply. There is little fear of our catching up or of reaching any market where the supply may exceed the demand, for some time to come.

We cannot find money to help reconstruct the world and simultaneously spend our earnings in luxuries which are beyond the means of the prudent and the thrifty. We cannot listen to the demands for six-hour days and five-day weeks and still hope to produce the materials for our own needs, let alone what the world requires of us. Neutral countries are sending raw materials into Germany with a pledged lien on the finished products, in response to the German request that she shall have the opportunity to employ her people and start her factories going.

It is reported, and there seems to be good foundation for the report, that the German workers are pledging themselves, through their local organizations, to be satisfied with a ten

hour day, and that in many places they are urging a 12 and 16 hour day until the peak of reconstruction be reached. I, for one, am not an advocate of any speeding up processes calculated to be harmful to the health and general welfare of the individual, but I would ask: If these reports be true, if Germany does this—and let there be no misconception as to the economic sense and the industrial will of the Germans—and in the meantime we, in America, are content to witness a gradual shortening of working hours and automatically restrict our production thereby, who, in the last analysis, will have won the war?

There never was a time when the workers of the world may need more money, and they may need better conditions, but the way to get these things is not to do poorer work and less of it. There never was a time in history when the workers, from the girls in the kitchen to skilled producers in the factories produced so little and asked so much as today. I am a worker myself, and I have never seen any intelligent hope of getting a raise in my salary by making my output less and punker than it is now. I find so much to do that I cannot find any day long enough.

In every group of human beings are to be found people who, like quack doctors, have an overnight remedy with a new nostrum to be applied for every new sickness. We are having quite a few nostrums presented to us today. I would that our ears might be relieved from the affliction of listening so much to persons who have noises in their heads which they mistake for constructive thought.

What the country needs more than anything else, gentlemen, is an invasion of common sense. Buying what you don't need is a pretty short and sure road to needing what you cannot buy. A condition of half-strike, half-producing, *all*-consuming cannot possibly endure. Five minutes of restraint from purchasing what you can do without at a time like this is worth ten years of cussing the profiteer.

It has been said that there has been much gnashing of wisdom teeth over reconstruction problems, but I warrant, not all wisdom teeth.

During the war universally we were inspired to put every ounce of energy into the raising of men, money and material, and into organizing

the nation to go out and destroy militant life. Now we are called upon to produce in order that we may lend money and send the products of every man's brains and arms to save life and to preserve civilization. No thoughtful American industrialist that I have met has ever quarreled with high wages, high, let us say, in comparison with wages paid for similar work in other parts of the world. For many years the wages paid to American railroad men have been considerably higher than those paid to railroad employes anywhere on the face of the globe, and yet we have been able to carry a ton of freight per mile cheaper than any other country in the world. It is the tendency to decrease production that the patriotic American citizen quarrels with to-day. However many be the theories for the solution of the vexing problems of the hour, I hold that there are two maxims which if universally and effectively applied, will solve most of the difficulties both here and in every other part of the world. As I think of the extent to which foreign exchange, foreign trade, domestic prosperity and all the international problems are linked up and based on this one great question, a question which may be interpreted in two simple words, "save" and "produce," I look, ahead, gentlemen, to the part which I hope America may play in the future, and I say, "Above all, in God's name, let us produce, and stimulate our fellows to produce, in order that we may anticipate the kind of America that we all want America to be. I thank you.

The President: I know I express the sensiments of all present when I extend to Mr. Walker our sincere thanks for his very able and instructive address.